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mobile wireless service as a substitute for wireline service. Nor has the Commission made any attempt to study the effect these changes have had on customer perceptions.

In sum, the Commission's recent conclusion that wireless service is not a substitute for wireline service should, by itself, rule out counting cut-the-cord customers as those won by competitors in the market share analysis in the Denver, Minneapolis, Phoenix and Seattle MSAs. But even the Commission had not reached that decision, the rationale offered by the Commission in the past for treating mobile wireless service as part of the wireline voice market must now be rejected.

III. Even If The FCC Defines The Wireline Voice Product Market To Include Mobile Wireless Service, Cut-The-Cord Customers of ILEC-Affiliated Wireless Carriers Should Be Excluded From The Competitive Market Share Calculation.

In the *6-MSA Order*, the FCC reiterated its prior holding that ILEC-affiliated wireless carriers, like Verizon Wireless, have the incentive to protect their wireline customer base.²⁶ Based on this conclusion, the Commission excluded Verizon Wireless' proportion of cut-the-cord customers from the total number of customers deemed to have been won by facilities-based competitors. Indeed, the Commission counted Verizon Wireless customers as Verizon ILEC customers for purposes of its market share calculation. However, the Commission included AT&T Mobility's share of the cut-the-cord customers in the total number of customers deemed to have been won by facilities-based competitors. This is so even though AT&T Mobility is affiliated with an ILEC. This differential treatment appears to be based on the Commission's assumption that ILEC-affiliated wireless carriers market and price their service in a manner that prevents customers from viewing the mobile wireless service as a substitute for wireline service within their ILEC regions, but ILEC-affiliated wireless carriers do not do this when competing outside of their ILEC regions. But there is no basis for this assumption.

Both Verizon Wireless and AT&T Mobility set their prices on a national, not regional, basis. For example, Verizon Wireless offers only "nationwide" individual and family voice plans.²⁷ Likewise, AT&T offers only "Nation" individual and family calling plans.²⁸ Both carriers recently introduced unlimited nationwide calling plans for \$99.99 per month. *See*

²⁶ *See 6-MSA Order*, Appendix B, n.6 ("As noted above, attributing Verizon Wireless' share to Verizon is consistent with our methodology in prior orders. This approach is warranted because, as the Commission repeatedly has found, 'a wireline affiliated [wireless] carrier would have an incentive to protect its wireline customer base from intermodal competition.'") (internal citations omitted).

²⁷ *See* Verizon, Voice Plans, <http://www.verizonwireless.com/b2c/store/controller?item=planFirst&action=viewPlanOverview&catType=voice&lid=//global//plans//voice+plans//view+all> (last visited Apr. 29, 2008) (describing all voice plans).

²⁸ *See* AT&T, FamilyTalk Cell Phone Plans, <http://www.wireless.att.com/cell-phone-service/cell-phone-plans/family-cell-phone-plans.jsp?WT.srch=1> (last visited Apr. 29, 2008).

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Mikkelsen White Paper nn.18-20. Consistent with the trend toward nationwide, unlimited service plans,²⁹ Verizon Wireless also recently introduced three "Nationwide Messaging" plans that allow "customers to use unlimited messaging on their wireless handsets."³⁰ These national pricing plans are evidence that AT&T Mobility and Verizon Wireless market and price their services outside of their ILEC territories in the same way that they market and price their services within their ILEC territories.

Accordingly, if the Commission concludes, as it has in the past and should in the future, that the services offered by Verizon Wireless and AT&T Mobility are not substitutes for, and do not belong in the same product market as, wireline voice service within these carriers' respective ILEC territories, the Commission must treat them exactly the same way outside of their ILEC territories. For example, in the Denver, Minneapolis, Phoenix and Seattle MSAs, AT&T Mobility and Verizon Wireless price their services in the same way that they price them in their respective ILEC territories. Since the Commission did not classify Verizon Wireless cut-the-cord customers in-region as counting toward the market share gained by competitors in the *6-MSA Order*, the Commission must exclude the Verizon Wireless and AT&T Mobility cut-the-cord customers from the competitors' market share in the four MSAs at issue here.

Finally, the Commission should treat Qwest Wireless cut-the-cord customers in the same way that it treated Verizon Wireless customers in the *6-MSA Order*. Just as Verizon has the incentive to protect their wireline customer bases from wireless competition in the MSAs at issue in the 6-MSA proceeding, so too does Qwest have that incentive in the four MSAs at issue here. Just as the Commission counted Verizon Wireless customers as Verizon ILEC customers for purposes of its market share calculation in the *6-MSA Order*, the Commission should treat Qwest Wireless customers as Qwest ILEC customers in this proceeding. Thus, in the Denver, Phoenix, Minneapolis and Seattle MSAs, the Commission should exclude Verizon Wireless, AT&T Mobility and Qwest Wireless cut-the-cord customers from its calculation of facilities-based competitors' market share, and it should include Qwest Wireless customers in the Qwest ILEC market share.

²⁹ It should be noted that these new flat-rate unlimited pricing plans are not designed to induce wireline customers to cut the cord. *See, e.g.,* John C. Hodulik, UBS Investment Research, "US Wireless 411," at 3 (Mar. 18, 2008) ("We believe the recent launch of unlimited voice for \$100 per month at AT&T and Verizon . . . appeals largely to the high-end subscriber base and will likely have limited impact on subscriber and ARPU trends."); *see also* Lehman Brothers Equity Research, "Sprint Nextel Corp.," at 2 (Feb. 29, 2008) (concluding that "the impact [of Sprint's \$99 unlimited voice and data offering] will be marginal given our estimate that the universe of customers impacted represents only a low single digit percent of the entire industry's customer base").

³⁰ *See* Press Release, Verizon, "Verizon Wireless Introduces Nationwide Messaging Plans" (Apr. 14, 2008), <http://news.vzw.com/news/2008/04/pr2008-04-14f.html>.

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IV. Conclusion.

For the foregoing reasons, the FCC should not include cut-the-cord wireless substitution in its competition analysis in the instant proceeding. If it does include cut-the-cord customers in its calculation of competitors' market share, it must at least exclude Qwest Wireless, Verizon Wireless, and AT&T Mobility cut-the-cord customers from the calculation.

Respectfully submitted,

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EXHIBIT B

April 22, 2008

VIA ECFS

Marlene H. Dortch
Office of the Secretary
Federal Communications Commission
445 12th Street, SW
Suite TW-A325
Washington, DC 20554

Re: *Petitions of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Minneapolis-St. Paul, Phoenix, and Seattle Metropolitan Statistical Areas, WC Docket No. 07-97*

Dear Ms. Dortch:

The undersigned parties hereby submit the attached white papers in the record in the above-captioned proceeding. The first white paper, by Kent Mikkelsen of Economists Incorporated, is entitled "Mobile Wireless Service to 'Cut the Cord' Households in FCC Analysis of Wireline Competition." The second white paper, by Joseph Gillan of Gillan Associates, is entitled "Properly Estimating the Size of the Wireless-Only Market." These papers address, respectively, whether mobile wireless service belongs in the wireline product market, and if so, the extent to which the FCC can rely on estimates of wireless-only subscribers to measure wireless-wireline substitution. Also attached hereto is Dr. Mikkelsen's curriculum vitae.

Please do not hesitate to contact me at (202) 303-1000 if you have any questions or concerns about this submission.

Respectfully submitted,

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Commission Tate
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**Mobile Wireless Service to "Cut the Cord" Households
in FCC Analysis of Wireline Competition**

Kent W Mikkelsen

April 21, 2008

Verizon filed petitions in 2006 seeking forbearance from certain regulations, including dominant carrier regulation applicable to its mass market switched access services and unbundling regulations, in six geographic areas.¹ In its December 2007 decision to deny these petitions, the Commission used market share statistics that reflected both wireline voice customers and certain mobile wireless voice customers—those that subscribe only to mobile wireless voice service and have "cut the cord" to wireline voice service.² Specifically, the numerator used to calculate Verizon's share included Verizon's wireline voice customers and Verizon mobile wireless customers that have "cut the cord." The denominator includes wireline customers of Verizon and competitors and all "cut the cord" customers.

It is my understanding that, in determining whether or not to forbear applying (1) dominant carrier economic regulation to mass market switched access services, and (2) unbundling regulations to DS-0, DS-1 and DS-3 loops and DS-1 and DS-3 interoffice transport facilities, the Commission evaluates, among other things, the degree of competition in providing wireline voice services to "mass market" customers.³ By including mobile wireless voice services in its calculation of market shares, the Commission appears to have concluded that mobile wireless voice services should be considered part of the wireline services market. Based

¹ *In re Petitions of the Verizon Telephone Companies for Forbearance to 47 U.S.C. § 160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Statistical Areas*, Memorandum Opinion and Order, 22 FCC Rcd. 21293, ¶ 1 (rel. Dec. 5, 2007) ("Verizon 6-MSA Order").

² *Id.* ¶¶ 27, 37 and Appendix B.

³ *See, e.g., id.* ¶ 37 ("We begin our analysis by examining competition in the retail and wholesale markets in the relevant MSAs. With respect to retail competition for mass market customers, Verizon's MSA-wide mass market shares . . . taken in conjunction with other factors[] are not sufficient to warrant forbearance from dominant carrier regulation. Consistent with our precedent, we likewise are not persuaded that these data, in themselves, support the grant of forbearance from UNE obligations.").

on the evidence I have reviewed, there is ample reason to doubt a market definition that includes mobile wireless services in the wireline services product market. If the relevant market includes only wireline services but not mobile wireless services, then including mobile wireless services in share calculations as the Commission has done does not accord with normal practices in assessing competition and tends to overstate the extent of competition.

Merger Guidelines approach to market definition

It is my understanding that the FCC assesses whether to grant a petition for forbearance from dominant carrier and unbundling regulations based in part on the extent to which the petitioner faces competition in the provision of the services for which it seeks forbearance. In order to undertake such an analysis, it is necessary to define the relevant product market. A considerable body of thought and experience in the assessment of competition has been developed in the context of antitrust analysis. The DOJ-FTC Merger Guidelines lay out a widely accepted method to define a "relevant market."⁴ The purpose for defining a relevant market is to distinguish products or services that compete closely with one another from products or services that are less important to competition. The Commission has itself used the Merger Guidelines approach to define relevant markets.⁵

Following the Merger Guidelines approach, a relevant market is "a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ('monopolist') likely would impose at least a 'small but significant and nontransitory' increase in price."⁶ The Merger Guidelines also define the relevant market as the

⁴ U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines*, 57 F.R. 41552 (1992) (rev. Apr. 8, 1997) ("Merger Guidelines").

⁵ See, e.g., *In re Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, 20 FCC Rcd. 18433, ¶ 21 (rel. Nov. 17, 2005) ("Verizon/MCI Merger Order"); see also *In re Applications of Nextel Communications, Inc. and Sprint Corporation For Consent to Transfer Control of Licenses and Authorizations*, Memorandum Opinion and Order, 20 FCC Rcd. 13967, ¶ 39 (rel. Aug. 8, 2005) ("Sprint/Nextel Merger Order").

⁶ Merger Guidelines, §1.11.

narrowest set of products or services that meet the criteria.⁷ In practice, the Merger Guidelines method considers a narrow set of products or services and investigates whether that set of products or services meets the criteria to be a relevant market. If the criteria for a relevant market are not met, the Merger Guidelines approach broadens the set of products or services under consideration and investigates whether the criteria are met by the broader set. Once a set of products or services is identified that meets the relevant market criteria, the Merger Guidelines approach proceeds to analyze the structure (i.e., the number and relative size of suppliers) of the relevant market.

Applying the Merger Guidelines approach to wireline services

Applying this method to the question at hand, one begins by considering the narrowest potential market definition — whether wireline voice services provided to mass market customers constitute a relevant market.⁸ One asks whether, if there were only one firm providing wireline voice service to a specific geographic area now or in the future, it would be profitable for such a firm to raise prices by a small but significant amount (e.g., 5-10 percent) for a significant period of time (e.g., one year).

A critical part of the answer to this question depends on how current purchasers of wireline voice services would respond to such a price increase. This is easiest to see by considering the extremes. If no purchaser of wireline services would drop its service in response to such a price increase, it would clearly be profitable for the hypothetical monopolist to raise price. At the other extreme, if all purchasers of wireline services would drop their service in response to such a price increase, it would clearly not be profitable to raise price. Such extremes are almost never observed, however. It becomes an empirical question to determine the extent to

⁷ *Id.* § 1.0.

⁸ The Commission has concluded in other proceedings that wireline services should not be included in the relevant market for mobile wireless services. See e.g., *In re Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation For Consent to Transfer Control of Licenses and Authorizations*, Memorandum Opinion and Order, 19 FCC Rcd. 21522, ¶ 239 (rel. Oct. 26, 2004) (“*AT&T/Cingular Merger Order*”). The issue discussed here—whether mobile wireless services should be included in the market for wireline services—though related, is different because the analysis starts by considering a hypothetical price increase for wireline services, not mobile wireless services.

which customers would decrease their purchases in response to such a price increase. It is also worth noting that growth or decline in the number of wireline voice customers for reasons other than a change in the price of wireline is not part of the market definition analysis.⁹

When the degree of price responsiveness has been determined, it is often useful to consider the variable profit margin¹⁰ that the hypothetical monopolist earns. Charging a higher price to customers that retain their service tends to increase profits, while giving up variable profits on customers that drop their service tends to decrease profits. Whether the hypothetical price increase is profitable overall—which in turn determines whether the set of products or services under consideration is a relevant product market—normally depends on the balance between these two factors.

Economists use the term “demand elasticity” to describe the extent to which customers will reduce their level of purchase in response to a change in price, holding other factors constant.¹¹ When the demand elasticity is known or can be estimated quantitatively, it has a direct role in determining whether or not the products or services under consideration are a relevant market. Very commonly, no suitable elasticity estimate is available, forcing analysts to rely on various indicators to guide a judgment about demand elasticity.

The most recent estimate of demand elasticity for wireline services in the U.S. of which I am aware is found in a 2003 paper by Rodini, Ward and Woroch.¹² The authors use data from 2000 and 2001 to estimate the demand elasticity for secondary fixed lines. They find that the

⁹ The market definition test is concerned with whether a hypothetical price increase would be unprofitable due to the loss of sales relative to the level of sales absent the price increase. If demand is shrinking or growing, this is adjusted for in assessing the level of sales that would be made absent the price increase.

¹⁰ Variable profit margin is usually defined as the difference between price and variable cost, expressed as a percentage of the price. Variable costs are those that increase or decrease with increases or decreases in the quantity of goods or services produced.

¹¹ Formally, demand elasticity can be expressed as the percentage change in quantity purchased associated with a 1 percent change in price.

¹² See Mark Rodini, Michael R. Ward and Glenn A. Woroch, “Going mobile: Substitutability between fixed and mobile access,” 27 *Telecommunications Policy* 457, 457-476 (2003).

demand for secondary fixed lines is relatively inelastic: -0.62 in 2001. In other words, an increase of 1 percent in the price of a secondary line would lead customers to decrease the number of such lines by only 0.62 percent. The authors also note that the demand for primary fixed lines is even more inelastic (i.e., the demand elasticity would be a smaller number in absolute value).¹³

Other authors have used the Rodini-Ward-Woroch demand elasticity estimate to answer the market definition question regarding wireline voice service.¹⁴ In this case, the determination is very easy. When the demand elasticity for a product is in the relatively inelastic range, an increase in price results in an increase in total revenues.¹⁵ Using the available estimate, a price increase of 1 percent is estimated to reduce the number of secondary (or primary) fixed lines by less than 1 percent, resulting in an increase in total revenues. Regardless of the variable profit margin, a price increase would be profitable. From this it follows that wireline service exhibiting the estimated demand elasticity is a relevant market.

A finding that wireline service is a separate relevant market without including mobile wireless service does not imply that there is no substitutability between wireline and mobile wireless services. It simply means that, in response to a small wireline price increase, purchasers of wireline service would not turn from wireline service to mobile wireless service in such great numbers that the wireline price increase would be unprofitable. In other words, one cannot rely on the presence of mobile wireless alternatives to constrain the price of wireline service. Rather, the price of wireline services is constrained principally by competition among firms supplying wireline service and by regulation.

¹³ Earlier studies have also found the demand for wireline service to be inelastic. As one paper put it, "Other work in this area generally supports [the] finding that the price elasticities for landline service approach zero in recent periods. . . ." Christopher Garbacz and Herbert G. Thompson, Jr., "Demand for telecommunications services in developing countries," 31 *Telecommunications Policy* 276, 278 (2007).

¹⁴ Phoenix Center for Advanced Legal and Economic Public Policy Studies, Policy Bulletin No. 10, "Fixed-Mobile 'Intermodal' Competition in Telecommunications: Fact or Fiction?" Mar. 31, 2004, <http://www.phoenix-center.org/pcpb.html>.

¹⁵ This can be verified in most basic economics textbooks. See, e.g., Paul A. Samuelson and William D. Nordhaus, *Economics* 72 (17th ed. 2001).

Shares within a relevant market

Once a relevant market has been defined, competition analysis normally proceeds to determine the shares of sales that each supplier makes (or, in some cases, could make) in the relevant market. Normal procedure does not include assigning a share to customers that choose not to purchase the product in the relevant market. In the case of wireline service, shares would be assigned to the ILEC, CLEC and cable providers based on their sales or the number of lines in service. Households with no wireline connection, such as those that had "cut the cord," would not be included in the share calculation. Including households with no wireline connection would depart from standard economic practice and could overstate the amount of competition for wireline services.

Additional evidence regarding a wireline market

As noted above, determining the set of products or services that belongs in a well-defined relevant market rests on facts regarding demand elasticities and margins. In general, the greater the number of substitutes, and the closer or more similar those substitutes are to the products or services in question, the higher the demand elasticity will be. The demand elasticity for a product or service is not immutable, and can change over time. Given that Rodini-Ward-Woroch derived their demand elasticity estimate for wireline telephone service using data from 2000 and 2001, it is appropriate to consider whether secondary indicators offer evidence as to the extent to which demand elasticity for wireline telephone service has changed. Nonetheless, I am not aware of any analysis that shows that the demand for wireline service has become sufficiently elastic that wireline service (exclusive of wireless services) is no longer a relevant market.

Wireline and mobile wireless services are obviously similar in that they both offer voice communication. However, they also have numerous distinguishing characteristics. Wireline service typically provides high and consistent transmission quality, unlimited service for a flat rate, a common connection point for all members of a household, subscription costs that are generally lower than for mobile wireless service, and more accurate and reliable enhanced 911

emergency capability than mobile wireless service.¹⁶ Mobile wireless service can be used both at home or away, often limits the usage available without additional fees, typically costs more than wireline service, offers variable transmission quality, and is often limited by the battery life of a user's cell phone. Mobile wireless service can also combine text or Internet capabilities with conventional phone service.

Moreover, while the flat-rate pricing features familiar to wireline customers are increasingly available to mobile wireless users,¹⁷ and the practice of offering larger "buckets" of monthly minutes as part of a subscription package has made mobile wireless pricing structures more closely resemble the typical wireline pricing structure, prices for wireline and mobile wireless service still differ greatly. For example, AT&T offers a voice-only unlimited wireless calling plan for \$99.99 per month.¹⁸ By contrast, Verizon's unlimited local and long distance landline calling plan is only \$46.99 per month.¹⁹ Similarly, Verizon offers unlimited wireless local and long distance calling and mobile Internet for \$99.99 per month,²⁰ but Verizon's

¹⁶ Three-quarters of landline telephone users responding to a recent survey said that voice quality, reliability and consistency of service were greater with their landline home phone than with mobile wireless service. See <http://newscenter.verizon.com/press-releases/verizon/2008/new-survey-shows-83-percent-of.html> (last visited Apr. 3, 2008).

¹⁷ At least since 2000 and continuing into 2008, the Commission has pointed to the beginning and spread of unlimited local wireless calling plans. See *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Fifth Report, 15 FCC Rcd. 17660, 17668-69 (rel. Aug. 18, 2000), and Twelfth Report, 23 FCC Rcd. 2241, ¶ 113 (rel. Feb. 4, 2008).

¹⁸ See, e.g., http://www.wireless.att.com/cell-phone-service/cell-phone-plans/individual-cell-phone-plans.jsp?WT.svl=calltoaction&q_defaultPlanSkuld=sku1210020 (last visited Apr. 8, 2008) (describing AT&T's \$99.99 unlimited Individual Cell Phone Plan, which does not include any data features).

¹⁹ See, e.g., <https://www2.verizon.com/Residential/Phone/Unlimited+Calling+Plans/Unlimited+Calling+Plans.htm> (last visited March 19, 2008); see also <http://promo.consumerfiber.com/FiOS-Bundle> (last visited Mar. 21, 2008) (advertising stand-alone retail price (i.e., prior to "Bundle Savings Discount") for "Verizon Freedom Essentials" unlimited calling plan as \$46.99).

²⁰ See, e.g., <http://www.verizonwireless.com/b2c/splash/splash.jsp?v=7> (last visited Apr. 7, 2008) (describing Verizon's Unlimited Anytime Calling Basic Plan, including HTML browsing, but not data messaging, for \$99.99 per month).

unlimited local and long distance landline calling plan bundled with its basic DSL plan is only \$62.48.²¹

At some point in time, mobile wireless service may be a sufficiently close substitute for wireline service that it would serve as a competitive check on wireline prices. However, there is insufficient evidence to support this conclusion. I am not aware that anyone has demonstrated that the demand for wireline service is now so elastic that wireline service (exclusive of wireless service) is not a relevant market.

The evidence the Commission has cited to suggest that mobile wireless service competes with wireline service is largely dated or unpersuasive.²² For instance, the Commission found evidence that in 2005 Sprint planned significant efforts to induce wireline customers to "cut the cord" and expressed hope that the merger of Sprint and Nextel would promote mobile wireless competition with wireline services. This may have been a reasonable expectation in 2005. However, when the Commission makes decisions several years later judging whether mobile wireless belongs in the wireline market, it would now be reasonable to investigate whether the "nascent" intermodal competition the Commission found has materialized. I have been unable to find evidence that Sprint actually pursued the marketing plan the Commission referred to in 2005 or that targeting "cut the cord" customers has been a major Sprint business strategy in recent years, if ever.

The Commission cites as evidence of wireless-wireline competition the increasing percentage of the population that has "cut the cord." This percentage, by itself, does not give much, if any, insight into the demand elasticity for wireline service. Certain types of consumers who have subscribed to both wireline and mobile wireless services find that the special features of wireline service are not of sufficient value to justify continuing with wireline service, given

²¹ See <http://www22.verizon.com/ForYourHome/NationalBundles/NatBundlesHome.aspx> (last visited Apr. 4, 2008) (offering Verizon "Freedom Essentials" unlimited local and long distance calling plan for \$46.99 per month and Verizon "High Speed Internet Starter Plan" with download speeds of up to 768 Kbps for an average of \$15.49 per month, for a total monthly price of \$62.48).

²² *Verizon/MCI Merger Order* ¶¶ 90-91; *Sprint/Nextel Merger Order* ¶¶ 141-143.

the price and quality of mobile wireless service available. For instance, the value of having a common connection point for all members of a household may be low or zero for single-person households or adults living with unrelated roommates.²³ Such a decision does not provide any additional information about the demand elasticity of consumers that continue to subscribe to wireline service. Yet it is the ability of mobile wireless to constrain the wireline prices charged to these remaining wireline consumers that is at issue in assessing wireline competition.

The Commission has noted that wireline carriers "consider" possible substitution between wireline services and mobile wireless services when making strategic plans regarding wireline services.²⁴ However, the Commission has not disclosed how or to what extent this factor enters the carriers' strategy decisions. Such consideration may not provide any evidence regarding the degree of price sensitivity between wireline and mobile wireless service. For instance, strategic plans may note that the widespread adoption of mobile wireless service has decreased the minutes of local and long distance traffic over landlines and contributed to a decrease in the number of landlines in use. Such references provide no evidence that landline service providers are altering their prices or services to compete with mobile wireless services. Even if documents provide some evidence of competition, it may be limited to discussions of particular customer types that are most likely to "cut the cord."

Similarly, Qwest's petition for forbearance in Denver raises several arguments which shed little or no light on the product market for wireline services. First, Qwest points out that there are more wireless subscribers than wireline access lines in Colorado.²⁵ While it is likely true that consumers who have mobile wireless service would be more willing to drop wireline

²³ The National Center for Health Statistics 2006 survey found, "Nearly one-half of all adults living with unrelated roommates live in households with only wireless telephones (44.2 percent). This is the highest prevalence rate among the population subgroups examined." See <http://www.cdc.gov/nchs/products/pubs/pubd/hestats/wireless2006/wireless2006.htm> (last visited Feb. 28, 2008).

²⁴ See, e.g., *Verizon/MCI Merger Order* ¶ 91; and *AT&T/Cingular Merger Order* ¶ 241.

²⁵ Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Colorado Metropolitan Statistical Area, Declaration of Robert H. Brigham and David L. Teitzel Regarding The Status Of Telecommunications Competition In The Denver, Colorado Metropolitan Statistical Area. WC Dkt. No. 07-97, ¶¶ 36-7 (filed Apr. 27, 2007).

service than those without, this observation conveys no information about the degree of willingness of wireline subscribers to drop wireline service in response to a price increase. After advancing the “cut the cord” argument discussed above, Qwest then states that consumers who have both wireline and mobile wireless services are decreasing wireline usage minutes while increasing mobile wireless service usage minutes. It is possible that some consumers are more willing to drop their landline service if they use it less, but one still cannot tell what the willingness level is and whether it is sufficiently high that mobile wireless service should be included in the relevant market with wireline service.

Suppose that the Commission is able through additional inquiry to gather sufficient evidence to conclude that mobile wireless voice service is part of the same relevant market as wireline voice service. The Commission must still be careful not to use such a finding to infer that mobile wireless voice service belongs in the same relevant product market with wireline services for services other than voice such as ADSL, DS1, and DS3 services. In evaluating whether to grant forbearance in unbundling DS-1 and DS-3 loops and DS-0 loops used to provide ADSL, the Commission considers competition in providing such loops. A comparison of Verizon’s wireless Internet and ADSL offerings is illustrative. Verizon’s mobile wireless Internet “BroadbandAccess Plan”²⁶ provides average download speeds of 600 Kbps to 1.4 Mbps, average upload speeds of 500 to 800 Kbps and a monthly data usage allowance of 5 GB for \$59.99 per month.²⁷ By contrast, one of Verizon’s residential DSL plans, its “High Speed Internet Service Power Plan,” offers faster download speeds of up to 3 Mbps, upload speeds of up to 768 Kbps and no data usage limits for only \$29.99 per month.²⁸ Just as with voice service, it is not clear that mobile wireless offers a competitive alternative to services such as ADSL, DS1, and DS3 services provided by wireline. Without defining relevant product markets with

²⁶ Verizon advertises its BroadbandAccess service as a way to “connect to the Internet, your company intranet or email” and to “enjoy the freedom and mobility to work where you need to without the hassles of Wi-Fi hotspots.” See <http://b2b.vzw.com/productsservices/wirelessinternet/> (last visited Apr. 7, 2008).

²⁷ See <http://www.verizonwireless.com/b2c/store/controller?item=planFirst&action=viewPlanDetail&sortOption=priceSort&catId=409&lid=//global//plans//wireless+internet+plan> (last visited Apr. 8, 2008).

²⁸ See <http://www22.verizon.com/content/consumerdsl/plans/all+plans/all+plans.htm> (last visited Apr. 8, 2008). This rate could increase after the first year.

respect to these services, the Commission cannot make a sound decision regarding what degree of competition exists in providing these services, and thus whether forbearance would harm consumers.²⁹

Conclusion

In evaluating petitions for forbearance, the Commission examines the state of competition for wireline services in a specific geographic area and at a specific point in time. The Commission appears to have little basis for determining that mobile wireless services are now part of the relevant market for wireline services. If circumstances change and if additional evidence is presented, it may be appropriate to make such a determination in the future. For now, however, well-accepted procedures for assessing competition would not calculate wireline shares by including mobile wireless-only customers that do not purchase wireline services because they have "cut the cord."

²⁹ I understand that in its Anchorage forbearance order, the Commission explicitly declined to define relevant markets. See *In re Petition of ACS Anchorage, Inc. Pursuant to Section 10 of the Communications Act of 1934, as Amended, for Forbearance from Section 251(c)(3) and 252(d)(1) in the Anchorage Study Area*, Memorandum Opinion and Order, 22 FCC Rcd. 195, ¶ 12 (2007). It is sometimes possible to make competitive evaluations without defining a relevant market if one can make limiting statements such as "the relevant market is at least as broad as X." Such statements should only be made when one has done sufficient analysis of the relevant product market to dispose of the competitive issue and it is not necessary to pursue the market definition exercise to its conclusion. Such statements would be based on, not offered as a substitute for, careful analysis of product substitution issues.

EXHIBIT C

May 15, 2008

VIA ECFS


Marlene H. Dortch
Secretary
Federal Communications Commission
Washington, DC 20554

**Re: Petitions of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. §
160(c) in the Denver, Minneapolis-St. Paul, Phoenix, and Seattle
Metropolitan Statistical Areas, WC Docket No. 07-97**

The undersigned parties hereby submit the attached white paper, by Joseph Gillan of Gillan Associates, entitled "The Irrelevance of Resale and RBOC Commercial Offers to Competitive Activity in Local Markets." This paper demonstrates that no competitive weight should be attributed to RBOC resale and Commercial Offer lines in any analysis of RBOC market power.

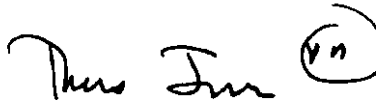
Please contact the undersigned if you have any questions.

Respectfully submitted,



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May 2008

The Irrelevance of Resale and RBOC Commercial Offers to Competitive Activity in Local Markets

It is not uncommon for industry observers to periodically develop measures of local market share including, *without comment*, the lines that competitors lease using Section 251(c)(4) Resale and the ILEC's so-called "Commercial Offers."¹ By simply including such lines without discussion, however, these analyses implicitly attribute to resale and Commercial Offer lines the same competitive weight as lines served over the competitor's own switching and/or loop facilities.²

The purpose of this paper is to highlight a fundamental weakness inherent with resale and the Commercial Offers – that is, that neither provides a meaningful competitive restraint on the incumbent, or a significant commercial opportunity to the competitor.³ Unlike a CLEC leasing loops and paying the cost-based rates required by Sections 251(c)(3) and 252, a CLEC using resale or a Commercial Offer cannot meaningfully discipline ILEC exercises of market power to increase prices to the detriment of consumers.

The only conclusion that can be supported by an analysis of the lines served by resale and the RBOCs' Commercial Offers is that there is no functioning wholesale market in the local exchange. Because the lines served by these options impose no price constraint on the incumbent, or provide a meaningful commercial opportunity for the entrant, the lines should not be afforded any weight in an analysis of retail competition.

¹ The term "Commercial Offer" is used in this paper to refer to those products provided by the Regional Bell Operating Companies ("RBOCs") as replacements for the Unbundled Network Element Platform ("UNE-P"). Although operationally comparable to UNE-P, as explained later in this paper, the prices for the RBOCs' Commercial Offers have been unilaterally established by the RBOC, at levels reflecting the RBOCs' market power and desire to protect profitability.

² As a general rule, competition in the small and medium business market is commonly provided by competitive local exchange carriers ("CLECs") leasing last-mile access from the ILEC connected to a CLEC-owned switch and/or router to provide service. In contrast, most residential competition today comes from the coexistent cable company that relies on its own loop facilities (i.e., the cable plant) to reach subscribers.

³ Resale reached its zenith more than *eight years ago* and, even then, served less than 3% of the market, while the Commercial Offers have shown rapidly decaying volumes ever since their introduction.

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The Competitive Irrelevance of Resale

As a practical matter, resale is structurally deficient and lacks *any* ability to constrain the market power of an incumbent. There are three reasons that resale does not limit the market power of the incumbent and should, therefore, be afforded no weight in any market share calculation used to measure the incumbent's ongoing market power.

First, resale is nothing more than the re-offering of the retail service as designed by the incumbent.⁴ There is no meaningful ability for the purchasing carrier (that is, the reseller) to differentiate its product from that offered by the incumbent through innovation.

Second, the methodology used to establish the wholesale price of the resold service is to apply a simple discount to the retail price charged by the incumbent. This pricing approach has three practical effects that ensure that resale never poses a competitive limit on the actions of the incumbent:

- * The "retail-less-discount" pricing structure creates a wholesale price that parallels the retail price, ensuring that resellers can never impose a competitive constraint on the incumbent's prices. This is because the wholesale price moves up with any increase in the retail price. Consequently, the ILEC is able to simultaneously raise its rivals' costs in lock-step with any desired retail rate increase, effectively ensuring that rivals match – and, therefore, reinforce – the incumbent's rate increases.⁵
- * The potential profit margin (*i.e.*, the difference between the retail and wholesale price) is the same whether or not the customer purchases just basic local service or also subscribes to a variety of optional features.⁶ To the incumbent, customers that purchase

⁴ Section 251(c)(4) of the Communications Act of 1934, as amended ("Act") requires ILECs "to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail," with Section 252(d)(3) requiring that State commissions determine such wholesale rates by "excluding [from the retail price] the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier."

⁵ In contrast, if an ILEC attempted to increase its prices by a small, but significant and nontransitory amount, a CLEC using cost-based UNEs would be able to design its product and set its prices as it saw fit, thereby threatening the incumbent with competitive share loss. However, in this way, a UNE-based CLEC could discipline the ILEC's price increases in a way that resale cannot.

⁶ Specifically, the percentage discount – and, therefore, relative profit margin – remains constant, although the per-line margin may increase somewhat as revenues increase. It is common for profitability to be judged as a percentage of revenue and, in the final analysis, this mathematical difference between measuring profit as a percentage or in absolute dollars does not change the fundamental unattractiveness of resale as an entry strategy.

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multiple features comprise a highly profitable market because the underlying incremental cost to add such features to an account is trivial, while the relative retail price is high. To the reseller, however, serving such customers causes the reseller to incur higher costs, because the cost to a reseller to add a feature to a customer's line is the relatively high retail price of the feature (reduced by the wholesale discount), and not the much lower incremental cost enjoyed by the incumbent. To the reseller, there are no "cherries to pick," which are so critical to competitive success.⁷

- * Finally, the methodology used to establish the wholesale discount – *i.e.*, removing from the incumbent's retail price an estimate of the incumbent's marketing and customer support costs – does not generally provide a margin large enough to attract and sustain entry. These discounts were typically set shortly after the Act was enacted, at a time when the incumbent's marketing costs reflected its monopoly status. As a monopoly (or near-monopoly), the incumbent only incurred marketing costs to increase its revenues through incremental sales. In contrast, an entrant incurs the much *higher* marketing costs needed to win customers from the incumbent. Combined with the advantages of its economies of scale,⁸ the conflicting marketing imperatives of an incumbent monopoly and the entrant effectively assure that any discount derived from the costs an incumbent avoids would be insufficient to cover the costs an entrant would incur.

Third, resale only makes the entrant a "half-a-carrier," because it does not permit the entrant to provide access services to its customers. In the resale scenario, the reseller continues to share each of its customers with the incumbent, because the incumbent retains the lucrative access portion of the product mix for each of the resellers' customers.⁹ This fact – *i.e.*, that the incumbent remains the access provider to the

⁷ In any market with an established incumbent – and, in telecommunications, the incumbent not only enjoys a 100-year head start, but decades of government protection from competition – the natural progression of entry is to first compete for high-value customers, then extend service to other customers over time. With resale, the across-the-board discount from the incumbent's retail rate means there are no high-value customers to support initial entry.

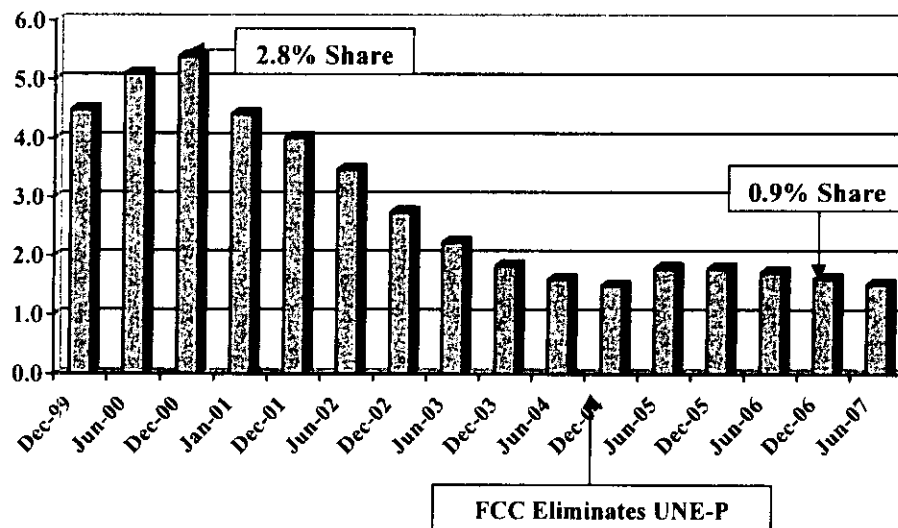
⁸ Like most commercial activities, marketing and customer support are likely to enjoy scale economies. That is, the larger the base of subscribers, the lower the per-unit cost. As such, the cost avoided by an incumbent (essentially serving the entire market) for marketing and customer care is likely to be smaller (per unit) than the cost that would be incurred by an entrant serving a small fraction of the market. Moreover, even if both faced the same marketing *problem* (which, as explained above, they do not), the cost structure of the entrant would likely be higher (particularly as it first enters a market) than the cost enjoyed by the incumbent.

⁹ In simple terms, local exchange carriers offer two products (and enjoy two revenue streams) over the same facility: (a) the retail service offered the end user to attract it to the

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resellers' customers – has two impacts. The first is that an important revenue stream (carrier access charges) is denied the reseller, who must cover all of its costs solely through retail revenues. Second, and perhaps more importantly, the reseller must continue to pay *usage*-based access charges to the incumbent, even to provide toll services to its own retail customers. This usage-sensitive cost structure effectively prevents the reseller from offering the flat-rated bundles of local and long distance calling so popular with consumers and many businesses.

Figure 1: National Resale Trends
(millions of lines)



Given the structural disadvantages described above, it not surprising that resale has never played a significant role in the market. As shown in Figure 1, even at its zenith – now more than eight years ago – its nationwide market penetration was only 2.8%. Today, that penetration has fallen to less than 1% and is continuing to decline. The sole exception to this continuous decay was immediately after the FCC eliminated UNE-P in the *Triennial Review Remand Order*.¹⁰ Although this decision caused a temporary increase in resale lines, the trend immediately began to decay again and has continued downward ever since.¹¹

carriers' network; and (b) the access service sold to other carriers, to originate and, more importantly, terminate long distance calls to those subscribers.

¹⁰ *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, 20 FCC Rcd 2533 (2005) ("TRRO"), affirmed *Covad Communications v. FCC*, 450 F.3d 528 (D.C. Cir. 2006).

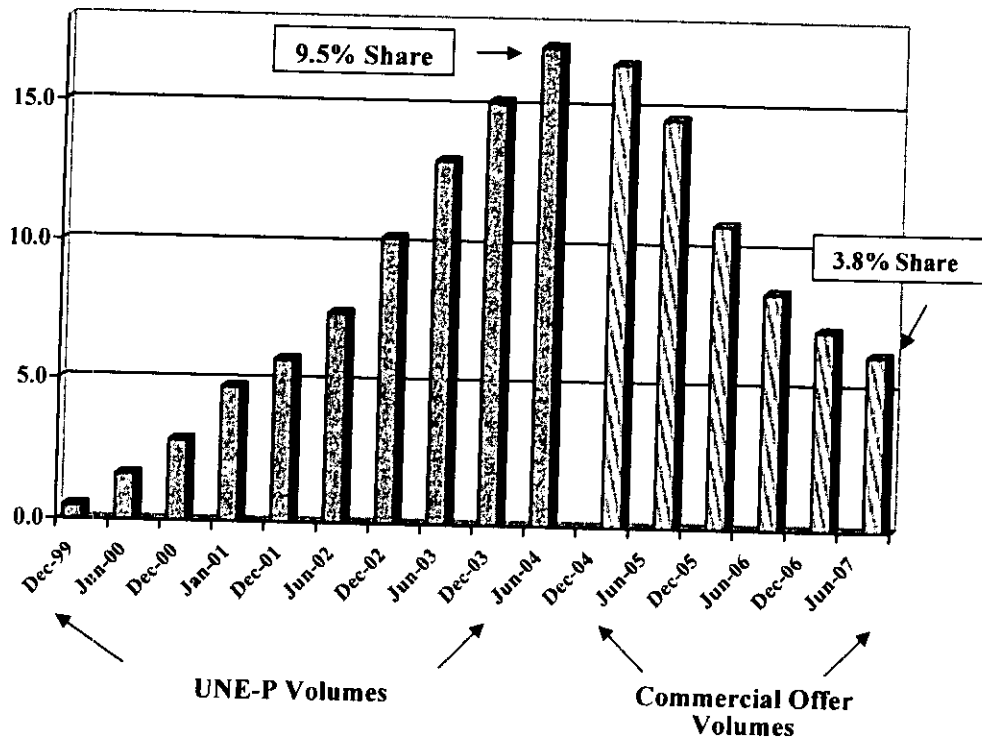
¹¹ It is telling that the FCC's pricing rules applicable to resale, which had been challenged by the RBOCs, were *vacated* and remanded by the Eighth Circuit in July 2000 and the FCC has never adopted a replacement. Obviously, if the resale option was negatively affecting the incumbents in a material way, the incumbents would have asked the FCC to translate their

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The Declining Significance of RBOC Commercial Offers

In contrast to resale, the unbundled network element platform (UNE-P) – which was priced at cost-based rates pursuant to Section 252(d) and the FCC’s TELRIC pricing standard – initially succeeded at supporting mass market competition, in large part because it was not hampered by any of the structural deficiencies of resale. Because UNE-P enabled entrants to lease a generic loop, switching and transport platform at cost-based rates established by a neutral arbiter (the state commission), the strategy allowed the CLEC to set the rates, terms and conditions of its offering wholly independent of the ILEC’s retail pricing in the market. Moreover, the cost-based rates enabled an entrant to enjoy the same basic cost structure as the incumbent, allowing the competitor to innovate by offering service packages that *differed* from those of the incumbent, including the all-important flat-rate packages of local and long distance service that transformed the

Figure 2: National UNE-P/Commercial Offer Trends
(millions of lines)



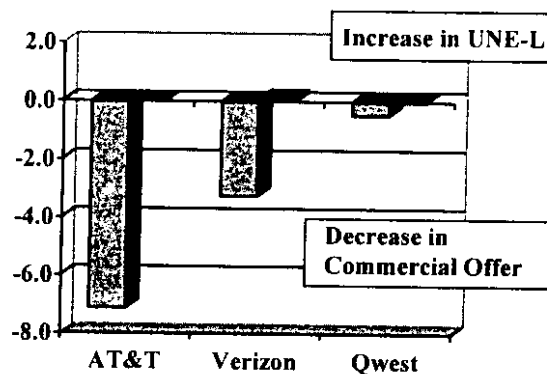
appellate victory into new pricing rules that would produce a lower discount. Resale is so competitively irrelevant, however, there has been no effort to have new rules adopted or lower discounts approved.

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market.¹² When UNE-P was priced at cost-based rates established by the *regulator*, the option could constrain the market power of the incumbent; once the prices were established by the *incumbent*, however, that role has disappeared.

The FCC's *Triennial Review Remand Order* effected a fundamental change in the economic attractiveness and stability of UNE-P, replacing this important wholesale arrangement with Commercial Offers unilaterally priced by the incumbent RBOC without – for all practical purposes – regulatory oversight.¹³ For consumers, this means that the CLEC's cost structure is no longer independent of the RBOC's pricing decisions for its own telecommunications services. As the RBOC increases the price of its end user services, the RBOC can also increase the prices for its Commercial Offers so as to support its price increases. Furthermore, RBOCs can price Commercial Offers to eliminate CLECs from more attractive market segments. Thus, unlike a CLEC using UNE-P, the CLEC using RBOC Commercial Offers is unlikely to be able to discipline ILEC attempts to exercise market power by raising prices. As a result, the RBOC Commercial Offers have replaced the competitive promise of UNE-P with widespread market exit. Because the consequence of imposing a high price on the CLEC is higher revenues to the RBOC until the CLEC exits, the RBOCs have no incentive to offer a reasonable wholesale price.¹⁴

Figure 3
Comparing Increase in UNE-L to
Decline in Commercial Offer Lines
(Dec. 2004 to Jun. 2007)



¹² Although similar packages are today offered by incumbents, the incumbents first introduced such packages as a competitive response to the innovative offerings of UNE-P based carriers such as Z-Tel Communications and MCI.

¹³ It is not the purpose of this analysis to describe in detail the competing theories concerning whether the RBOCs' commercial offers satisfy their ongoing Section 271(c)(2)(B) obligation to offer competitors access to unbundled loops, transport, and switching, whether these Section 271 elements meet the "just and reasonable" rate standard of Section 201, or whether there is a legitimate State role arbitrating the rates for Section 271 offerings. Although these issues are not yet settled, the courts have thus far determined that the FCC has exclusive jurisdiction to review Section 271 rate issues, and the FCC has provided no further guidance to the industry. The purpose of this analysis is not to develop or resolve these questions, but to emphasize that as a result of the ambiguity surrounding these issues, the RBOCs are not today regulated in the prices they charge for the so-called Commercial Offerings that contain these Section 271 elements.

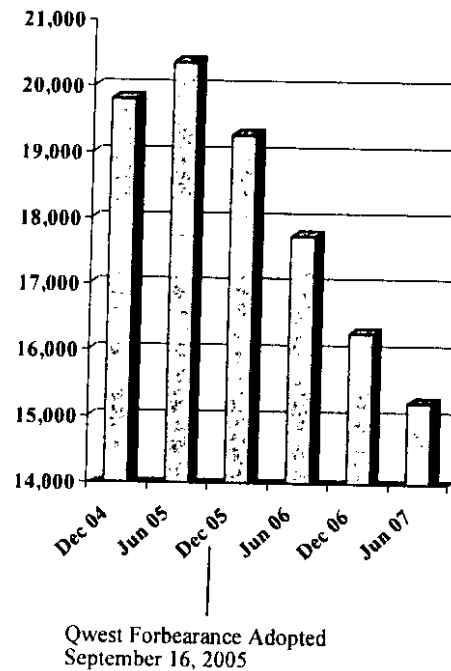
¹⁴ Before the courts began limiting State authority to review RBOC pricing of alternatives to UNE-P, a number of States had reviewed whether the prices imposed by the RBOCs in such commercial agreements were just and reasonable. Significantly, not a single State that has

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Importantly, the rapid decline in UNE-P (now Commercial Offer) lines is not validation of the predictive judgment in the *TRRO* that carriers would shift such lines to their own switches or switching provided by another carrier. If that predictive judgment were correct, the decline in UNE-P/Commercial Offer lines would be offset by an increase in UNE loops.¹⁵ To the contrary, as shown in Figure 3, the loss in UNE-P lines has *not* been accompanied by any material increase in UNE-L lines.¹⁶ The predictive judgment that the elimination of UNE-P would be offset by a shift in these lines to UNE-L has been shown to be wrong.

The core problem exposed by Figure 3 – that is, the absence of regulatory oversight does not lead to reasonable wholesale offerings that are priced independently from the ILEC's own retail pricing decisions and that support competition – is not limited to the mass market and the inadequacy of the RBOCs' Commercial Offers. A similar result occurred in the Omaha market following the FCC's predictive judgment that Qwest would continue to offer meaningful wholesale services after Qwest's legal obligation to offer unbundled loops and transport at cost-based rates was removed through forbearance.¹⁷

Figure 4: Effect of Omaha Experiment on UNE-Loop Competition - Nebraska



reviewed these prices has ever concluded that the prices imposed by the RBOCs were just and reasonable.

¹⁵ Any carrier capable of completely bypassing the incumbent through its own loop facilities (such as, for instance, a cable-based entrant) would not likely have *ever* relied upon UNE-P (at least within its loop footprint). Consequently, there is no reason to believe that CLECs are substituting their own loop facilities for UNE-P lines to any significant degree.

¹⁶ It should be noted that the comparison in Figure 3 overstates the level of substitution between UNE-L and UNE-P because the decline in UNE-P lines consists almost entirely of analog facilities serving traditional POTS customers, while the vast majority of UNE-L facilities leased by CLECs are high-speed digital facilities used to provide more complex services in the business market. If the analysis compared the decline in UNE-P lines to the offsetting increase in *analog* UNE loops, the imbalance and decline in CLEC activity would be even greater.

¹⁷ See Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area, WC Docket No. 04-223, Memorandum Opinion and Order, 20 FCC Rcd 19415 (2005) ("*Omaha Forbearance Order*"), *aff'd* *Qwest Corporation v. Federal*

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Figure 4 demonstrates that the effect of the Omaha forbearance decision has been a collapse in wholesale volume, as Qwest increased rates between 30% (individual DS0s) and 178% (DS3s).¹⁸ These price increases caused a significant decline in competitive activity, with UNE loop volumes declining by 25% for the entire State of Nebraska.¹⁹

The Omaha Experiment reinforces the conclusion drawn from the broader Commercial Offer analysis above – that is, when the RBOC is permitted to set the price of its wholesale offerings without oversight, those wholesale offerings do not support retail competition and cannot constrain the retail pricing of the incumbent.

Conclusion

The evidence concerning resale and the Commercial Offers of the RBOCs provide further evidence that these carriers enjoy substantial market power, particularly for wholesale services. Because the pricing of such arrangements protects the retail pricing strategy of the RBOC, no competitive weight should be attributed to resale and Commercial Offer lines in any analysis of RBOC market power.

Communications Commission, Case No. 05-1450, (D.C. Cir. Mar. 23, 2007). Specifically, the FCC predicted that competition from the facilities of Cox (the cable-based provider of telephony services in the Omaha market), as well as Qwest's continuing obligations under Section 271, would keep wholesale rates at just and reasonable levels and thereby protect retail competition. See *Omaha Forbearance Order*, at ¶¶ 66, 79.

¹⁸ See Letter to Marlene H. Dortch, Secretary, Federal Communications Commission, from William Haas, McLeodUSA, WC Docket No. 04-223 (filed Nov. 17, 2007) ("*McLeodUSA Ex Parte*"). McLeodUSA further explained in this filing that it intends to exit the Omaha market if the FCC does not reverse its forbearance experiment.

¹⁹ Data limited to the Omaha market is not publicly available.